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139792—37——1

In the Supreme Court of the United States

OCTOBER TERM, 1936

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

RAYMOND I. BASHFORD

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered in the above cause on January 22, 1937, affirming the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 127) is reported in 33 B. T. A. 10. The opinion of the Circuit Court of Appeals is reported in 87 F. (2d) 827.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered January 22, 1937. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Taxpayer owned stock in A corporation, which transferred its assets to B corporation in a statutory reorganization. Taxpayer exchanged his stock in A corporation for stock in B corporation, cash and stock in C corporation. C corporation is the parent of B and the instigator of the reorganization plan. The question is whether the gain represented by the C stock is taxable, which depends upon whether the C stock is stock of a corporation a party to the reorganization, under Section 112 (b) (3), or "other property" under Section 112 (c) (1), Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra,* pp. 14–18.

STATEMENT

The facts, except those disclosed by the testimony of two witnesses, were stipulated before the Board of Tax Appeals (R. 19–56). Separate findings of fact were not made by the Board. Its findings of fact were included in its opinion (R. 127–143), and they may be summarized as follows:

Prior to October 7, 1930, Peerless Explosives Company, Union Explosives Company and the latter's wholly owned subsidiary, Black Diamond Powder Company, called herein Peerless, Union and Black Diamond, were corporations engaged in the manufacture and sale of explosives. They were incorporated in the States of Delaware, West Virginia and Pennsylvania, respectively. (R. 19–20, 128.) These corporations were both purchasers from and competitors of Atlas Powder Company, herein called Atlas, a Delaware corporation (R. 129). Atlas was not satisfied with its position of rivalry with the other three corporations and desired to remove the competition and acquire the business of Peerless, Union and Black Diamond. Early in 1930, its president conceived the plan of attaining this end by means of reorganizing the three competitive companies into a new corporation to be controlled by Atlas. In order that its identity would not be apparent, the early negotiations to carry out this plan were made on behalf of Atlas by individual agents. (R. 129–130.) The identity of Atlas was not disclosed until the agents had secured from the majority stockholders of Peerless and Union their oral assurances that they would exchange their stock under the plan proposed (R. 130). It was stressed by the agents in dealing with the stockholders that a strong financial interest was represented and would participate in the plan by furnishing funds, and that the two agents

of Atlas and the principal stockholders of Peerless and Union would be officers in the new company (R. 130).

The main features of the reorganization plan were that Peerless, Union and Black Diamond were to be consolidated into Peerless-Union Explosives Company, herein called the new company, that the holders of stock of the old companies would receive for that stock cash, Atlas stock and stock in the new company, and that Atlas would furnish the new company with sufficient cash and stock in Atlas to complete the transaction in exchange for controlling amounts of the new company's common and preferred stock (R. 130–131).

On September 22, 1930, Atlas caused the new corporation to be incorporated under the laws of Delaware for the purpose of acquiring the business and assets of Peerless, Union and Black Diamond. Atlas subscribed to all of the original issue of stock of the new company, 10 shares of common and 10 of preferred, all of which was issued to Atlas. Later the capital stock of the new company was greatly increased. On October 2, 1930, the board of directors of Atlas approved the proposed reorganization and the incorporation of the new company and authorized its officers to invest in the capital stock of the new company to a substantial extent in consideration of $960,560.25 in cash and shares of common and preferred stock of Atlas. (R. 131–132.)

On October 7, 1930, the majority stockholders of Peerless and Union entered into written contracts with the agents of Atlas to deliver their shares of stock in their respective corporations to the agents, who were acting as promotors of the new company, in exchange for cash, shares of common stock of the new company and shares of common and preferred stock of Atlas in agreed amounts. Certain warranties and agreements as to carrying out the reorganization were made by the agents. (R. 132–135.) On the same day, October 7, 1930, the agents of Atlas and the new company contracted in writing that the agents would exchange for cash, stock in Atlas and stock in the new company the stock in the old companies which they had obtained. There were further agreements relative to the employment of stockholders of the old companies by the new, to the dissolution of the old companies and the acquisition of their assets and the assumption of their liabilities, and to the reimbursement of stockholders for any income tax imposed upon them growing out of the transaction. (R. 135.) Atlas' agents also secured options on practically all the minority stockholdings in Peerless and Union.

On October 7, 1930, the transfers and exchanges were made pursuant to the agreements and reorganization plan. The old companies were dissolved. The result was that the new company was the owner of practically all the stock and all the assets of the old companies. Atlas was the owner

of all the preferred stock and over 57% of the common stock of the new company. (R. 135–136.)

The taxpayer, respondent herein, was one of the majority stockholders of Peerless. His part in the plan was the exchange of his stock in Peerless for cash, stock in the new company and Atlas stock. (R. 132–133.) The Commissioner of Internal Revenue assessed a deficiency against him (R. 12–14) upon the theory that there had been a statutory reorganization effected between the three old companies and the new company as the latter had acquired all the stock and assets of the former, but that, as to Atlas, it was not a party to such reorganization, and, therefore, its common and preferred stock received in exchange by the taxpayer was to be treated as "other property" in the statutory reorganization and the gain thereupon was to be recognized along with the cash received, under the provisions of Section 112 (c) (1), Revenue Act of 1928, *infra,* pp. 14–15.

Before the Board, the Commissioner changed his position and claimed that no statutory reorganization was effected, but that the entire transaction constituted a sale, and that the gain upon both the stock of the new company and Atlas Powder Company should be recognized (R. 139).

The Board of Tax Appeals sustained the contentions of the taxpayer and held that there had been a statutory reorganization effected between the three old companies and the new corporation

and that the Atlas Powder Company was a party thereto by reason of its initiation of and intimate connection with the plan. Consequently, the gain upon the Atlas stock was held to be unrecognized under Section 112 (b) (3). (R. 141–142.) This decision of the Board was based upon its former decision in *Fifth Avenue Bank of New York* v. *Commissioner,* 31 B. T. A. 945, affirmed by the Circuit Court of Appeals for the Third Circuit, June 16, 1936, 84 F. (2d) 787.

In the Circuit Court of Appeals the Commissioner conceded that a statutory reorganization had been effected between the new corporation and the three smaller companies by reason of the acquisition by the former of practically all the stock and all of the assets of the latter. The Commissioner contended, however, that Atlas was not a party to the reorganization within the statutory definition of that term, and that the intimate connection of Atlas with the reorganization and the participation of its subsidiary did not render Atlas a party.

The court held Atlas was a party to the reorganization within the literal terms of the statutory definition because Atlas had acquired a majority of the stock of all classes of the new company. The court further held Atlas a party to the reorganization, within the commonly understood meaning of that phrase, because of its intimate connection with the plan.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that Atlas was a party to the reorganization effected by its subsidiary with three other corporations.

2. In holding that Atlas was a party to the reorganization, within the literal terms of the statutory definition, because it had acquired a majority of the stock of all classes of its subsidiary.

3. In holding that Atlas was a party to the reorganization effected by its subsidiary by reason of its intimate connection with such reorganization.

4. In failing to hold that Atlas was not a party to the reorganization effected by its subsidiary.

5. In failing to hold that the stock of Atlas received by the taxpayer did not represent a continuing interest in the same enterprise.

6. In failing to hold that the stock of Atlas received by the taxpayer represented "other property" on which gain is recognized under Section 112 (c) (1), Revenue Act of 1928.

7. In affirming the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. Whether a corporation which forms a subsidiary corporation for the purpose of acquiring the assets and properties of a third corporation is a party to the statutory reorganization resulting from such acquisition and control by the subsidiary of another corporation is an important question of

Federal law, under the reorganization provisions of the Revenue Acts, which has not been but should be settled by this Court. In the instant case the court below determined that Atlas, the parent corporation, was a party to such reorganization within the literal terms of the statutory definition because the parent acquired a majority of the stock of all classes of the new, or subsidiary, company. Neither the governing statute, Section 112 (i) (1) (2), Revenue Act of 1928, *infra,* p. 16, nor the regulations promulgated thereunder, Treasury Regulations 74, Article 577, *infra,* p. 17, provide that a parent corporation is to be considered a party to a reorganization to which its subsidiary is a party.[1] We believe that the decision of the court below upon this point misapprehends the question involved and adopts an erroneous construction and extension of the statutory definition of the term "a party to a reorganization."

In the instant case the taxpayer, a stockholder in Peerless, a party to the reorganization and one of the transferring corporations, exchanged his stock therein for cash, stock of the acquiring subsidiary and stock of Atlas, the parent. The ultimate question is whether the gain upon the stock of the parent is free from recognition under Section 112 (b) (3), on the ground that the parent was a party to such reorganization. The underlying question thus would seem to be whether the stock

[1] This is equally true under prior Acts and Regulations.

of a parent company, which in turn owns the stock of a subsidiary, carries with it the necessary continuity of interest in the assets and affairs of the subsidiary so that any gain thereon is unrecognized to the same extent as on the receipt of stock in the corporation acquiring the assets. We believe that the decisions of this Court and the approved decisions of the Circuit Courts of Appeals require a negative answer.

In *Bus & Trans. Corp.* v. *Helvering,* 296 U. S. 391, it was contended on behalf of the Government that stock in a corporation which controlled the assets and properties transferred by the taxpayer did not represent the intimate interest in the affairs of the transferee required by the statute. While this Court there held that the transactions involved did not resemble either merger or reorganization, this Court further held that, "Neither party to the exchange acquired any definite immediate interest in the other" (p. 393). So, in the instant case, it is believed the stock of the parent corporation, Atlas, in the hands of the taxpayer does not represent any definite immediate interest in the transferred assets acquired by the new, or subsidiary, corporation.

Such conclusion is also supported, we believe, by the decision of this court in *Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378, 385, and by *Cortland Specialty Co.* v. *Commissioner,* 60 F. (2d) 937, 940 (C. C. A. 2d), certiorari denied, 288 U. S. 599, approved

in *Pinellas Ice Co.* v. *Commissioner,* 287 U. S. 462. We find no authoritative court decision to the contrary.

2. The court below decided in the instant case that, even if Atlas were not a party to the reorganization by reason of its acquisition of the subsidiary corporation's stock, it was a party, within the meaning of the statute, because of its intimate connection with the reorganization of the other corporations. This conclusion of the court rests upon the finding of the Board of Tax Appeals that the entire idea and plan of reorganization was conceived and executed by Atlas, that it furnished the necessary cash and its own stock to carry out the plan and without its participation there would have been no reorganization. This was the basis for the Board's decision and the court below affirmed the conclusion of the Board that Atlas was a party to the reorganization because it was thus the motivating force of the entire proceeding.

Upon this question the decision of the court below appears to be squarely in conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Commissioner* v. *Groman,* 86 F. (2d) 670, in which a petition for certiorari, filed by the taxpayer, is now pending in this Court, No. 854, October Term, 1936. In the *Groman* case, the Government is filing a memorandum on behalf of the Commissioner in which it is pointed out that in view of the contrary constructions of the statutory

definition adopted in these two cases, involving almost identical transactions, the Commissioner does not feel warranted in opposing that petition.

The court below recognized that its decision upon this point was contrary to the construction of the definition "a party to a reorganization" adopted by the Circuit Court of Appeals for the Seventh Circuit, but felt constrained to reach a different conclusion. The facts of the *Groman* case are sufficiently similar to those in this case to require the conclusion that there is a direct conflict between the two decisions. Those facts are, of course, set out in the record, petition and memorandum filed in that case, and will not be repeated here. It is sufficient here to say that in that case, as in the instant case, the corporation which motivated the entire reorganization scheme furnished the necessary cash and stock to carry out the reorganization and after the consummation of the plan was in control of the new company.

The only distinction between the facts of the instant case and the *Groman* case is that in the latter the parent corporation, while it acquired all the common stock of the new company, acquired none of the preferred stock, as did Atlas. Such a distinction was not regarded as material by either court in construing the term "a party to a reorganization" involving a parent corporation and its subsidiary.

In view of the relative importance of the question involved and the obvious conflict in these two cases, it is believed the petition for certiorari should be granted by this Court and the conflict resolved.

CONCLUSION

Wherefore, it is respectfully prayed that this petition be granted.

STANLEY REED,
Solicitor General.

APRIL 1937.

APPENDIX

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * * *

(3) *Stock for Stock on Reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(4) *Same—Gain of Corporation.*—No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * * *

(c) *Gain from exchanges not solely in kind.*—

(1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange

consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(d) *Same—gain of corporation.*—If an exchange would be within the provisions of subsection (b) (4) of this section if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganiza-

tion, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(j) *Definition of control.*—As used in this section, the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

> ART. 577. *Definitions.*—The term "reorganization" as used in sections 112, 113, and 115 means—
>
> (1) A merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation),
>
> (2) A transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred,
>
> (3) A recapitalization, or
>
> (4) A mere change in identity, form, or place of organization, however effected.
>
> The term "a party to a reorganization" as used in sections 112 and 113 includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. This definition is not an all-inclusive one, but simply enumerates certain cases with respect to which doubt might arise.
>
> A person is, or two or more persons are, "in control" of a corporation, within the meaning of section 112, when owning—
>
> (1) At least 80 per cent of the voting stock, and

(2) At least 80 per cent of the total number of shares of all other classes of stock of the corporation.

As used in section 112, as well as in other provisions of the Act, the conjunction "or" is used to denote both the conjunctive and the disjunctive, and the singular is used to include the plural. For example, the provisions of article 574 are complied with if "stock and securities" are received in exchange as well as if "stock or securities" are received, and if securities in the same corporation, together with securities in another corporation a party to the reorganization or in other corporations parties to the reorganization, are received in exchange.

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